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Addendum StartPage: 0

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APPLICATION OF TEXAS-NEW § BEFORE THE STATE OFFICE
MEXICO POWER COMPANY, FIRST § FILING CLERK
CHOICE POWER, INC., AND TEXAS § OF
GENERATING COMPANY, L.P. TO §
FINALIZE STRANDED COST UNDER §
39.262 § ADMINISTRATIVE HEARINGS

**APPLICANTS' RESPONSE TO CITIES MOTION TO STRIKE PORTIONS
OF THE DIRECT TESTIMONIES OF EUGENE T. MEEHAN, LARRY W. DILLON,
LARRY P. GUNDERSON, AND 2004 TRUE-UP SCHEDULES**

COME NOW, Texas-New Mexico Power Company ("TNMP"), First Choice Power, Inc., and Texas Generating Company, L.P. ("Applicants") and file this response to the Cities of Lewisville, Dickinson, Friendswood, League City, Texas City, and La Marque ("Cities") Motion to Strike Portions of the Direct Testimonies of Eugene T. Meehan, Larry W. Dillon, Larry P. Gunderson, and 2004 True-Up Schedules. Order No. 5 in this proceedings requires this response to be filed no later than April 5, 2004. This response is therefore timely.

I. ARGUMENT

A. Response to Motion to Strike Testimony and Schedules Associated with Capacity Auction True-Up Request

On March 3, 2004, the Commission issued a Supplemental Preliminary Order which states that TNMP "cannot true-up power cost projections under PURA § 39.262(d) or P.U.C. SUBST. R. 25.263."¹ Applicants disagree with the Commission's Order because this testimony is directly relevant to the calculation Applicants are required to make under PURA and the Commission rules. Applicants intend to challenge all findings and conclusions arising from that order in the district courts of Travis County. In support of that suit and for the purposes of this response, Applicants rely upon the applicable briefs and discovery responses that have been filed in this proceeding including the following:

- Docket No. 29206, Item No. 64, TNMP's Brief on Threshold Legal/Policy Issue Related to Capacity Auction True-up (filed Feb. 10, 2004).
- Docket No. 29206, Item No. 93, Applicants' Reply Brief on Threshold Capacity Auction Issues (filed Feb. 17, 2004).

¹ Docket No. 29206, Supplemental Preliminary Order, at 6 (March 3, 2004).

223

- All discovery responses pertaining to the capacity auction true up, including but not limited to Applicant's original and amended responses to TIEC RFI Nos. 1-53, 1-63, 1-65.

Applicants' incorporate the above briefs and responses herein for all purposes.

B. Response to Motion to Strike Testimony Associated with Whether TNMP Imprudently Managed its Fuel Contract with Walnut Creek

The Cities argue that portions of Mr. Larry Dillon's testimony should be excluded because, in their view, the testimony addresses "the actions taken by TNMP in managing its fuel contract with Walnut Creek and whether such actions were imprudent."² Cities argue that this testimony should be stricken because the Commission's Preliminary Order provides that the issue of "whether TNMP imprudently managed its fuel contract with Walnut Creek" is not to be considered in this proceeding.³

The Applicants disagree with Cities' characterization of Mr. Dillon's testimony and assert that Mr. Dillon's testimony is being offered to show that TNMP made a "good faith" attempt to renegotiate its fuel contract as provided under section 39.252(d) of PURA. As set forth in Applicants' (i) Motion for Clarification and/or Reconsideration,⁴ (ii) Reply to Various Intervenor's Responses to Applicants' Motion,⁵ and (iii) Letter Regarding Applicant's Motion for Clarification,⁶ Mr. Dillon's testimony is being offered to support Applicants' position that they have complied with section 39.252(d) of PURA, which requires that the Commission consider TNMP's "good faith attempts" to renegotiate fuel contracts when determining the amount of stranded costs. Applicants' incorporate the aforementioned pleadings herein for all purposes.

Furthermore, on April 2, 2004, the Administrative Law Judges (ALJs) issued Order No. 16, clarifying the Commission's Preliminary Order. The ALJs in Order No. 16 stated that "the Commission's Preliminary Order does not foreclose Applicants' ability to present evidence and

² Docket No. 29206, Item 192, Motion of Cities to Strike Portions of the Direct Testimonies of Eugene T. Meehan, Larry W. Dillon, Larry P. Gunderson, and 2004 True-Up Schedules, at 4 (filed March 25, 2004).

³ Id. at 3 (citing Preliminary Order, at 9)

⁴ Docket No. 29206, Item No. 85, Applicants' Motion for Clarification and/or Reconsideration of Commission's Preliminary Order (Feb. 17, 2004).

⁵ Docket No. 29206, Item No. 149, Applicants' Reply to Various Intervenor's Responses to Applicants' Motion for Clarification of the Preliminary Order (March 2, 2004).

⁶ Docket No. 29206, Item No. 163, Letter Regarding Applicants' Motion for Clarification (March 4, 2004).

arguments on how TNMP met the requirements of PURA § 39.252(d) . . .[a]ccordingly, Applicants' may present evidence that it used good faith in its contract price renegotiations.”⁷

The portions of Mr. Dillon's testimony that Cities have requested to be stricken are being offered to show that TNMP used good faith in its Walnut Creek contract price renegotiations. First, Cities is requesting that the following referenced testimony be stricken (to aid in placing the referenced portion in context, the entire Question & Answer is included below):

Page 1, lines 24-27

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

21 A. The purpose of my testimony is three fold. First, I describe certain maintenance
22 and repair activities undertaken at TNP One to protect and enhance the value of
23 TNP One after the Legislature passed Senate Bill 7. Second, I describe my
24 participation in the bidders' meetings at the plant site. Third, I explain the good
25 faith efforts TNMP undertook to negotiate a reduction in costs under its lignite
26 supply contract with Walnut Creek Mining Company as a part of our efforts to
27 mitigate potential stranded costs (emphasis added).

As is clearly shown by the underlined portion of this testimony, Mr. Dillon is testifying to TNMP's good faith attempt to renegotiate the terms under the Walnut Creek fuel contract – and not on the issue of whether TNMP prudently managed that contract. Second, Cities is requesting that the following portions of Mr. Dillon's testimony excluded:

Page 6, line 1 through Page 9, line 7

A copy of this testimony is attached hereto and illustrates without a doubt that all of Mr. Dillon's testimony pertains to TNMP's good faith attempts to renegotiate its fuel contract. A review of the questions asked alone illustrates that Mr. Dillon's testimony is limited to the issue of TNMP's good faith efforts to renegotiate its fuel contract.

Page 6 (emphasis added)

1 **Q. WERE YOU INVOLVED IN TNMP'S EFFORTS TO RENEGOTIATE THE FUEL**
2 **PRICE UNDER THIS CONTRACT IN 2000?**

4 **Q. AT THAT TIME WHAT WAS THE SCOPE OF YOUR RESPONSIBILITIES WITH**
5 **RESPECT TO THE EFFORTS TO RENEGOTIATE THE CONTRACT?**

11 **Q. DID TNMP MAKE A GOOD FAITH EFFORT TO NEGOTIATE A PRICE**
12 **REDUCTION UNDER THE TERMS OF THE FSA?**

⁷ Docket No. 29206, Item No. 217, Order No. 16 – Denying Applicants' Motion for Clarification and/or Reconsideration of Preliminary Order, at 4 (filed April 2, 2004).

14 Q. WHAT ACTIONS DID TNMP TAKE IN ITS GOOD FAITH EFFORT TO
15 RENEGOTIATE THE WALNUT CREEK CONTRACT?

Page 7 (emphasis added)

6 Q. WHY DO YOU THINK THAT THE APPROACH TNMP TOOK WAS IN GOOD
7 FAITH?

27 Q. DID TNMP CONSIDER THE IMPACT OF ITS ACTIONS ON THE COMPANY'S
28 STRANDED COSTS?

Page 8 (emphasis added)

5 Q. HAVE YOU READ THE PROPOSAL FOR DECISION IN DOCKET 27576?

7 Q. DO YOU BELIEVE THAT TNMP ACTED IMPRUDENTLY WITH RESPECT TO
8 ACHIEVING REDUCTIONS IN THE PRICE OF LIGNITE WHEN IT REFUSED
9 TO GIVE UP SIGNIFICANT RIGHTS THAT COULD HAVE AFFECTED THE
10 LONG-TERM VALUE OF THE PLANT?

25 Q. WHY DO YOU CONSIDER TNMP'S EFFORTS A GOOD FAITH ATTEMPT TO
26 RENEGOTIATE THE WCMC FUEL CONTRACT IN AN EFFORT TO MITIGATE
27 POTENTIAL STRANDED COSTS?

As shown by the underlined text almost all of the questions ask for a response relating directly to TNMP's efforts to renegotiate the fuel contract. The only questions that do not ask for direct responses on that issue deal with issues that are otherwise relevant or, in fact, did receive a response pertaining directly to TNMP's good faith efforts. In response to the question on page 7, lines 27-28, for example, Mr. Dillon's reply ends with the following sentence: "By negotiating for an acceptable short-term resolution and, when we could not achieve that, vigorously prosecuting the price arbitration, TNMP acted in good faith to obtain favorable changes in the terms of the Walnut Creek contract" (emphasis added).

Another question, which might appear objectionable because it uses the word "imprudently," in fact, receives a response that pertains to the good faith considerations given to certain terms in the negotiations. The response to the question posed on page 8, lines 7-10, is as follows:

11 A. No. TNMP believed that, to meet the standard of good faith renegotiation of its
12 fuel contract, it had to seek a current price reduction while maintaining the value
13 of TNP One. In doing so, TNMP also firmly believed that it should not

14 compromise its rights and bargaining leverage for the future. When TNMP could
15 not obtain that result through negotiation, it attempted to achieve the same result
16 through arbitration. While the arbitration did not result in a current price
17 reduction, TNMP retained all of its future rights and negotiating leverage and
18 thereby protected and enhanced the long-term value of the plant. While I
19 disagree with the Proposal for Decision's (PFD) conclusion on TNMP's prudence
20 with respect to its fuel expenses during the reconciliation period, those
21 conclusions are not pertinent here. I understand that the Commission's inquiry
22 here concerns whether TNMP acted in good faith to renegotiate its lignite supply
23 contract in an effort to mitigate stranded costs. There is no doubt in my mind
24 that TNMP met that standard (emphasis added).

As is illustrated by the underlined portions of this testimony as well as the discussions above, Mr. Dillon's testimony is being offered for the sole purpose of showing that TNMP acted in good faith in attempting to renegotiate its fuel contract with Walnut Creek. Consideration of this issue is mandated by section 39.252(d) of PURA and allowed by the ALJs in Order No. 16. Failure to allow this testimony to be admitted and considered would lead to an arbitrary and capricious decision. *Fleetwood Community Home v. Bost*, 110 S.W.3d 635, 645 (Tex. App. – Austin 2003, no pet. h.) (“An agency abuses its discretion in reaching a decision if it omits from its consideration factors that the legislature intended the agency to consider, includes in its consideration irrelevant factors, or reaches a completely unreasonable result after weighing only relevant factors.”).

II. CONCLUSION

WHEREFORE, PREMISES CONSIDERED, Applicants pray that they be granted relief consistent with the requests contained herein and, specifically, that the ALJs deny Cities' Motion to Strike on all grounds.

Respectfully submitted,



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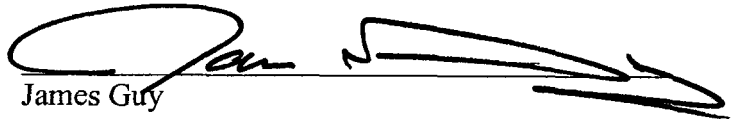
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CERTIFICATE OF SERVICE

Counsel for Applicants hereby certifies that a true and correct copy of the attached pleading was served on all parties of record on April 5, 2004, by hand delivery, facsimile transmission, electronic transmission, and/or first class mail.


James Guy

BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS

APPLICATION OF

**TEXAS-NEW MEXICO POWER COMPANY,
TEXAS GENERATING COMPANY, L.P.; AND
FIRST CHOICE POWER, INC.**

TO FINALIZE STRANDED COST UNDER PURA §39.262

**PREPARED DIRECT TESTIMONY AND EXHIBITS
OF
LARRY W. DILLON**

**ON BEHALF
OF
TEXAS-NEW MEXICO POWER COMPANY
FIRST CHOICE POWER, INC.
TEXAS GENERATING COMPANY, L.P.**

JANUARY 22, 2004

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TABLE OF CONTENTS

I.	INTRODUCTION AND QUALIFICATIONS.....	1
II.	PURPOSE OF TESTIMONY	1
III.	ACTIONS TAKEN TO ENHANCE AND PROTECT THE VALUE OF THE ASSETS	1
IV.	DESCRIPTION OF ACTIVITIES WITH BIDDERS.....	4
V.	WALNUT CREEK FUEL CONTRACT.....	5
VI.	CONCLUSION	9

EXHIBIT LWD-1

BIOGRAPHICAL SKETCH OF LARRY W. DILLON

EXHIBIT LWD-2

ACTIVITIES UNDERTAKEN TO IMPROVE MARKETABILITY AND PERCEPTION OF TNP ONE

9

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.**

3 A. My name is Larry W. Dillon. I am employed as a consultant. My business
4 address is 1024 Remuda Drive, Fort Worth, Texas 76108. I am appearing as an
5 expert witness for the applicants. I was Vice President for Texas New Mexico
6 Power Company – Power Resources until April 2003. I was President of Texas
7 Generating Company LLC until April 2003.

8 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE**
9 **UTILITY INDUSTRY?**

10 A. Exhibit LWD-1 provides a biographical sketch outlining my educational
11 background and my experience in the electric industry.

12 **Q. HAVE YOU TESTIFIED BEFORE IN A REGULATORY PROCEEDING?**

13 A. Yes. I presented pre-filed direct testimony in P.U.C. Docket Nos. 17751, 25931,
14 and 27576. I presented live direct and rebuttal testimony in Docket No. 25931. I
15 also testified in P.U.C. Docket No. 4247, Application for Declaratory Relief
16 Regarding Compliance with P.U.C Subst. Rule 052.02.044(d) Meter Tampering,
17 Edward R. Classen Matter.

18
19 **II. PURPOSE OF TESTIMONY**

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

21 A. The purpose of my testimony is three fold. First, I describe certain maintenance
22 and repair activities undertaken at TNP One to protect and enhance the value of
23 TNP One after the Legislature passed Senate Bill 7. Second, I describe my
24 participation in the bidders' meetings at the plant site. Third, I explain the good
25 faith efforts TNMP undertook to negotiate a reduction in costs under its lignite
26 supply contract with Walnut Creek Mining Company as a part of our efforts to
27 mitigate potential stranded costs.

28

29 **III. ACTIONS TAKEN TO ENHANCE AND PROTECT THE VALUE OF THE**
30 **ASSETS**

31 **Q. WHAT ACTIONS WERE UNTAKEN TO ENHANCE AND PROTECT THE**
32 **VALUE OF TNP ONE?**

33 A. Three types of activities both before and during the sale process to enhance and
34 protect the value of TNP One. In addition to performing regular, routine

1 maintenance and housekeeping activities, we undertook the following: (1)
2 activities to improve the marketability and overall perception of the plant; (2)
3 timely initiation of scheduled outages and associated activities; and (3) continued
4 communication with the plant employees to help minimize uncertainty.

5 **Q. WHAT ACTIVITIES WERE UNDERTAKEN TO IMPROVE THE**
6 **MARKETABILITY AND PERCEPTION OF THE PLANT?**

7 A. Generally, we cleaned the plant through normal maintenance procedures. We
8 conducted a walk-through of the facility and created a list of activities to prepare
9 the plant for sale. Exhibit LWD-2 lists those activities. In addition, we painted
10 various systems within the plant. We painted the brine concentrator system,
11 motors, pumps, some tanks, and railings. The cost of this work was
12 approximately \$50,000. All of these activities would normally have been done
13 over time, but were intentionally conducted prior to the offering for sale to
14 improve the overall perception of the plant. During the performance of activities
15 to prepare the plant for sale, we identified no required major modifications or
16 repairs.

17 **Q. DID THE PLANT PERSONNEL CONTINUE TO CONDUCT ROUTINE**
18 **MAINTENANCE ACTIVITIES AT THE PLANT, INCLUDING PLANNED**
19 **OUTAGES?**

20 A. Yes. TNMP conducted all routine, preventive maintenance activities and
21 performed necessary repair and replacement work during the scheduled
22 outages. TNMP recognized that it had to spend reasonable dollar amounts to
23 keep our maintenance program up to date despite the anticipated sale.

24 **Q. WAS THERE ANY DISCUSSION ABOUT DELAYING ANY OF THE PLANNED**
25 **OUTAGES AT TNP ONE PRIOR TO THE SALE?**

26 A. Yes. Because outages are very expensive, we discussed the possibility of
27 delaying two planned outages. The Plant had an outage of Unit 1 scheduled in
28 the spring of 2001. We decided it was important to complete that outage despite
29 the anticipated sale because we felt that all required maintenance should be up
30 to date. The outage maintenance performed was complete except for a low
31 pressure turbine inspection whose maintenance was not then required under the
32 manufacturer's recommendations. The second was an outage planned for Unit
33 2 scheduled for the fall of 2002. Due to the recently instituted change from a 12-
34 month inspection cycle to an 18-month inspection cycle, we wanted to make sure

1 that Unit 2 was functioning properly on the extended inspection cycle prior to the
2 sale. We felt this would be very important to maintain the value of the plant. We
3 proceeded, as scheduled, with the outage rather than take advantage of the
4 opportunity to delay it until after the sale and risk a lower sales price resulting in
5 additional stranded cost.

6 **Q. PLEASE DESCRIBE THE SCOPE OF WORK PERFORMED DURING EACH**
7 **SCHEDULED OUTAGE THAT WAS TAKEN BETWEEN THE TIME SENATE**
8 **BILL 7 PASSED AND THE TIME THE PLANT WAS SOLD.**

9 A. In the spring of 2000, we took a planned outage on Unit 1 to inspect the boiler.
10 During the outage, we replaced combustor nozzles and made refractory repairs
11 in the cyclone. We also took an outage on Unit 2 in June 2000 to repair and
12 replace generation-related equipment. The incremental cost plus the associated
13 payroll and benefits for these outages was \$998,529.

14 In the spring of 2001, we took a planned outage on Unit 2 for a boiler
15 inspection, boiler feed-pump repair, refractory repair, and other routine
16 maintenance. The incremental cost plus payroll and benefits associated with this
17 outage was \$822,483.

18 In the fall of 2001, we took an outage on Unit 1 for boiler inspection,
19 combustor nozzle inspection, refractory repair, and turbine valve inspection and
20 repair. Although a plant outage was not necessary, during 2001 we purchased
21 and installed a new reverse osmosis system to treat the feed water to the boiler
22 and turbines. The old system was functioning, but the new RO system was more
23 efficient and effective. The incremental cost plus payroll and benefits for this
24 outage and new system was \$1,065,298. Other minor outages were taken on
25 both units during the fall of 2001. We installed potential transformers and
26 current transformers to meet the new ERCOT metering requirements under
27 deregulation. These outages were short and were taken over two weekends.

28 In October 2002, we conducted an overhaul of Unit 2. This overhaul
29 included a low-pressure turbine inspection, and an inspection of the boiler,
30 combustor nozzles, and tubing. We also repaired the boiler feed pump,
31 conducted an acid cleaning of the boiler, resurfaced the combustor water wall,
32 and did refractory repair. The incremental cost plus payroll and benefits for this
33 outage was \$1,277,884.

1 Q. WHY WERE CONTINUED COMMUNICATIONS WITH PLANT EMPLOYEES
2 ABOUT THE ANTICIPATED SALE IMPORTANT TO ENHANCE AND
3 PROTECT THE VALUE OF THE PLANT?

4 A. We knew that the planned sale of the plant might cause stress for the employees
5 and might even lead to the premature departure of important parts of the
6 workforce. We believed that the plant would have greater value to a purchaser if
7 we were able to retain the experienced employees and we believed that effective
8 communication was the key to employee retention.

9 Q. WHAT ROLE DID YOU PLAY IN COMMUNICATING WITH THE EMPLOYEES
10 REGARDING THE SALE OF THE PLANT?

11 A. I was actively involved in communicating with the plant employees to minimize
12 the uncertainty they might feel due to the pending sale of the plant. In particular,
13 there were ongoing meetings with employees about how the sale was
14 progressing and how it might impact them. We had these meetings on both a
15 personal and group level. We tried to respond to concerns on an individual-by-
16 individual basis. With only three employees leaving the Company before the
17 sale, I believe we succeeded in retaining an experienced workforce at the plant.

18
19 **IV. DESCRIPTION OF ACTIVITIES WITH BIDDERS**

20 Q. DID YOU PARTICIPATE IN ANY OF THE BIDDERS' MEETINGS AT THE
21 PLANT?

22 A. Yes. I participated in all of the meetings held with potential bidders. I attended
23 those meetings, responded to questions, and ultimately made presentations after
24 the list of potential bidders had been narrowed. I also participated in several of
25 the plant tours with various bidders.

26 Q. DURING THE PLANT VISITS, DID BIDDERS RAISE QUESTIONS
27 CONCERNING THE UNIQUENESS OF CIRCULATING FLUIDIZED BED (CFB)
28 TECHNOLOGY?

29 A. Yes. CFB technology was not commonly used in the United States. Many
30 bidders had a general curiosity and a general lack of understanding of CFB
31 technology. Many of the bidders had a background in and knowledge of gas
32 plants, but very few had extensive knowledge about coal plants. Those who did
33 have a background with coal plants were usually familiar with pulverized-coal
34 (PC) plants rather than CFB plants. There was not a long history of the

1 operation of CFB plants as compared to PC plants. Thus, there were questions
2 concerning the operation, cycling ability, and efficiency of CFB technology.

3 **Q. DO YOU HAVE AN OPINION HOW POTENTIAL BIDDERS VIEWED THE**
4 **TECHNOLOGY?**

5 A. It was clear not everyone saw how a plant of this type would operate in the
6 context of their operations. Some had uncertainties how they would operate it in
7 a competitive market given its limited ability to effectively cycle. Some
8 expressed concerns about future maintenance requirements for plants using this
9 type of technology.

10 **Q. DID YOU HAVE POSITIVE FEEDBACK ON THE PLANT?**

11 A. Yes. During the bidders' meetings, I heard many positive comments concerning
12 the cleanliness of the plant, the positive attitude of the employees, the
13 knowledge of the employees on the plant operations, and the apparent care and
14 pride the employees took in operating and maintaining the facility. This feedback
15 confirmed that our efforts to protect the value of the plant succeeded.

16
17 **V. WALNUT CREEK FUEL CONTRACT**

18 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF TNP ONE'S FUEL SUPPLY.**

19 A. Texas lignite was TNP One's primary fuel source, but the facility was also
20 designed to burn western coal, natural gas and petroleum coke, as well as less
21 traditional fuels such as tire chips, wood chips, and oil filter fluff. TNMP
22 purchased its lignite requirements from Walnut Creek Mining Company
23 (WCMC).

24 **Q. PLEASE DESCRIBE THE FUEL CONTRACT WITH WALNUT CREEK MINING**
25 **COMPANY.**

26 A. TNMP purchased lignite under the fuel supply agreement (FSA) with WCMC.
27 The FSA provided for periodic price re-determinations to allow the parties an
28 opportunity to adjust the price upward or downward by a maximum of ten
29 percent. The price re-determination clause permitted a reduction in price if
30 TNMP could demonstrate that it could purchase a competitive fuel, delivered to
31 the plant, at a price below the then current contract price. If the parties could not
32 agree on a price reduction, the contract provided for arbitration. One of the price
33 redetermination periods began with negotiations in 2000.

1 Q. WERE YOU INVOLVED IN TNMP'S EFFORTS TO RENEGOTIATE THE FUEL
2 PRICE UNDER THIS CONTRACT IN 2000?

3 A. Yes.

4 Q. AT THAT TIME WHAT WAS THE SCOPE OF YOUR RESPONSIBILITIES WITH
5 RESPECT TO THE EFFORTS TO RENEGOTIATE THE CONTRACT?

6 A. I was Vice-President of Power Resources throughout this period. As such, I was
7 responsible for the operation of TNP One and for purchased power and fuel
8 purchase contracts. In that role, I was directly involved in most of the
9 discussions and negotiations between TNMP and WCMC concerning the
10 contract.

11 Q. DID TNMP MAKE A GOOD FAITH EFFORT TO NEGOTIATE A PRICE
12 REDUCTION UNDER THE TERMS OF THE FSA?

13 A. Yes.

14 Q. WHAT ACTIONS DID TNMP TAKE IN ITS GOOD FAITH EFFORT TO
15 RENEGOTIATE THE WALNUT CREEK CONTRACT?

16 A. In 2000, TNMP conducted test burns to prove that TNP One could burn
17 petroleum coke and western coal efficiently, to quantify the costs associated with
18 those fuels, and to provide other data points required by the contract to support a
19 price redetermination. Based on these test burns and other information
20 concerning the price of alternative fuels at the time, TNMP requested a price re-
21 determination. On August 30, 2000, TNMP requested the ten percent maximum
22 price reduction allowed under the FSA. This request was based on market
23 information and data available on September 1, 2000, that indicated the price of
24 alternate fuels was approximately 16.4% less than the price TNMP was paying
25 under the FSA. TNMP expected that this evidence would support a ten percent
26 reduction in the cost of lignite under the contract. When TNMP and WCMC
27 failed to reach an agreement during the 90-day negotiation period from
28 September 1, 2000, to December 1, 2000, the issue was referred to arbitration
29 as provided by the FSA.

30 An arbitration was conducted in 2001, and the arbitrators unexpectedly
31 denied TNMP's request for a price redetermination in August 2001. TNMP
32 appealed this decision to the courts. TNMP lost its appeal in the District Court.
33 TNMP then appealed that decision to the Court of Appeals, but dropped the
34 appeal at the request of the new owners of TNP One.

1 While the arbitration did not result in the ten percent price reduction that
2 TNMP sought, TNMP maintained its rights under the contract and did not give up
3 any rights that might have affected the value of TNP One to a future owner.
4 These efforts were undertaken in good faith and were reasonably calculated to
5 preserve and enhance the value of the plant.

6 **Q. WHY DO YOU THINK THAT THE APPROACH TNMP TOOK WAS IN GOOD**
7 **FAITH?**

8 A. We expended significant time and effort attempting to reach a negotiated
9 settlement. Negotiations did not succeed in obtaining an acceptable result
10 because WCMC made demands that would have required TNMP to give up
11 valuable future rights in return for the offered price reductions. WCMC's
12 demands were that TNMP's contractual rights to future test burns, important to
13 future price redeterminations, be restricted and that TNMP permit WCMC to
14 open a new seam for mining. I believed at the time that the concessions WCMC
15 demanded had a value of over \$16 million. TNMP invoked the price re-
16 determination clause of the contract that would permit TNMP to reduce the
17 contract price through arbitration without giving up any rights.

18 By first attempting to negotiate an acceptable price reduction and, failing
19 that, pursuing its arbitration rights under the contract, TNMP made a good faith
20 effort to achieve an acceptable reduction in the price of lignite without giving up
21 future rights under the contract and negotiating leverage. It vigorously pursued
22 its option to arbitrate and remedies available under judicial appeals of that
23 decision. Thus, TNMP engaged in commercially reasonable activities to pursue
24 the dual goals of reducing the current price of lignite for the ratepayers while
25 preserving important rights for future negotiations thereby preserving and
26 enhancing the overall value of the plant to potential purchasers.

27 **Q. DID TNMP CONSIDER THE IMPACT OF ITS ACTIONS ON THE COMPANY'S**
28 **STRANDED COSTS?**

29 A. Yes. We recognized the conundrum presented by the competition between the
30 impacts on current fuel price reductions and the impacts on the potential long-
31 term value of the plant to potential purchasers. We understood that accepting a
32 lower fuel price for the current period might negatively impact the long-term
33 value of the plant if the lower fuel price was connected with concessions related
34 to future negotiating leverage and the ability to support future price

1 redeterminations. By negotiating for an acceptable short-term resolution and,
2 when we could not achieve that, vigorously prosecuting the price arbitration,
3 TNMP acted in good faith to obtain favorable changes in the terms of the Walnut
4 Creek contract.

5 **Q. HAVE YOU READ THE PROPOSAL FOR DECISION IN DOCKET 27576?**

6 **A.** Yes.

7 **Q. DO YOU BELIEVE THAT TNMP ACTED IMPRUDENTLY WITH RESPECT TO**
8 **ACHIEVING REDUCTIONS IN THE PRICE OF LIGNITE WHEN IT REFUSED**
9 **TO GIVE UP SIGNIFICANT RIGHTS THAT COULD HAVE AFFECTED THE**
10 **LONG-TERM VALUE OF THE PLANT?**

11 **A.** No. TNMP believed that, to meet the standard of good faith renegotiation of its
12 fuel contract, it had to seek a current price reduction while maintaining the value
13 of TNP One. In doing so, TNMP also firmly believed that it should not
14 compromise its rights and bargaining leverage for the future. When TNMP could
15 not obtain that result through negotiation, it attempted to achieve the same result
16 through arbitration. While the arbitration did not result in a current price
17 reduction, TNMP retained all of its future rights and negotiating leverage and
18 thereby protected and enhanced the long-term value of the plant. While I
19 disagree with the Proposal for Decision's (PFD) conclusion on TNMP's prudence
20 with respect to its fuel expenses during the reconciliation period, those
21 conclusions are not pertinent here. I understand that the Commission's inquiry
22 here concerns whether TNMP acted in good faith to renegotiate its lignite supply
23 contract in an effort to mitigate stranded costs. There is no doubt in my mind
24 that TNMP met that standard.

25 **Q. WHY DO YOU CONSIDER TNMP'S EFFORTS A GOOD FAITH ATTEMPT TO**
26 **RENEGOTIATE THE WCMC FUEL CONTRACT IN AN EFFORT TO MITIGATE**
27 **POTENTIAL STRANDED COSTS?**

28 **A.** Negotiations under large, complex commercial contracts are always a very
29 difficult task particularly when the parties are trading against a number of
30 different contract provisions. It is as much an art as anything else. In this
31 instance the task was made more complicated by the dual statutory duty to have
32 reasonable fuel prices while attempting to mitigate future stranded costs. In this
33 case TNMP acted in good faith in its efforts to renegotiate the fuel contract and
34 mitigate stranded costs because at all times it attempted to achieve a current

1 reduction in fuel costs while protecting and enhancing the long-term value of the
2 plant. The fact that our efforts to reduce short-term fuel costs were ultimately
3 unsuccessful did not diminish the good-faith nature of our efforts. TNMP
4 expended a significant effort to negotiate a price reduction, to arbitrate the issue,
5 and to file an appeal in the state courts. It reasonably and vigorously pursued
6 the available options to preserve what it properly believed were important long-
7 term rights. TNMP therefore acted in a commercially reasonable manner.

8
9 **VI. CONCLUSION**

10 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

11 **A. Yes it does.**

**LARRY W. DILLON
BIOGRAPHICAL SKETCH**

NAME: Larry W. Dillon
BUSINESS ADDRESS: 1024 Remuda Drive
Fort Worth, Texas 76108

EDUCATION: Texas City High School - 1972 Graduate
United States Military Academy - July-September 1972
University of Houston - January 1973-December 1974
Texas A&M University - January 1975-May 1977 - Graduated Cum Laude with B.S.E.E.

Registered Professional Engineer: State of Texas, Serial No. 50266, December 1981

EMPLOYMENT RECORD:

DATES	POSITION	COMPANY	LOCATION
April 2003 to Present	Consultant	Self-employed	Fort Worth
March 1999 to April 2003	Vice President – Power Resources	TNMP	Fort Worth
Nov. 14, 1994 to March 1999	Vice President – Regional Customer Officer	TNMP	Fort Worth
Nov. 29, 1993 to Nov. 14, 1994	Vice President – Operations	TNMP	Fort Worth
August 27, 1990	Division Manager	TNMP	Texas City
May 16, 1990	Division Manager Elect	TNMP	Texas City
June 3, 1985	Division Engineering Manager	TNMP	Texas City
October 2, 1982	Division Engineer	TNMP	Clifton
December 26, 1981	Division Relay & Metering Engineer	TNMP	Texas City
December 1, 1979	Relay & Metering Engineer	TNMP	Texas City
May 1, 1977	Engineer	TNMP	Texas City
January 16, 1975	Student Engineer	TNMP	Fort Worth

ORGANIZATIONS:

PROFESSIONAL:

Institute of Electrical and Electronic Engineers (IEEE)
HKN (ETA KAPPA NU) Honor Society
ΦΚΦ (PHI KAPPA PHI) Honor Society
Texas Society of Professional Engineers
National Society of Professional Engineers

BOARD MEMBERSHIPS:

Texas Society to Prevent Blindness -
Galveston/Gulf Coast Chapter
Board of Directors
President Elect
Mainland Communities United Way
St. John's United Methodist Church
Overton Park United Methodist Church

SERVICE:

Jubilee 80 Celebration Committee Chairman - Texas City
Bay Street Park Committee – Texas City
Goals 2000 Committee Member – Texas City

La Marque Rotary Club
Club Secretary
Club Treasurer
Vice President Elect
Club President
Board of Directors

Texas City Rotary Club
Board of Directors
Statewide President Elect Training Seminar -
Instructor two years

19

Dillon, Larry

From: Faulkner, George
Sent: Friday, October 13, 2000 12:31 PM
To: Dillon, Larry
Subject: FW: Clean - up TNP One

Larry,
Attached is our plant cleanup plan by week from now until plant tours are scheduled for prospective buyers.
George

-----Original Message-----

From: Gilleland, Gary
Sent: Friday, October 13, 2000 12:22 PM
To: Faulkner, George
Subject: Clean - up

George,
This is an outline of our plans for the next few months. We will be issuing a weekly detailed schedule prior to the beginning of each week.



PlantCleanNov.doc

G²

Weekly Plant Clean-Up Outline Schedule November – Feb

A detailed list will be developed as each week approaches.

Week of Oct 30-Nov2

- Dismantle and remove old cooling tower fan blades
- Mow around cooling towers.
- Clean cooling tower pump houses
- Washdown equipment, repair oil leaks
- Use manlift and wash windows around Offices

Week of Nov 6-9

- Clean up warehouse 3
- Clean up & paint hydrogen tanks
- Washdown equipment, repair oil leaks
- Remove hoses that hang over side of boiler, affix permanent vacuum piping
- Sand blast/paint all fire hose housings

Week of Nov 13-16

- Repair roofs on oxy bottle rack on East Side of Unit #2
- Paint pipes at make up pond.
- Spray Round-Up on weeds around all ponds
- Paint equipment as determined

Week of Nov 20-23

- Sandblast/paint sump pumps at cooling tower both unit #1 and #2
- Warehouse #2 - haul all unneeded material and clean office area (dispose of old books and paper material).
- Paint equipment as determined

Week of Nov 27-30

- Repair lagging on limestone building
- Heater deck - Paint HECW lines that were installed a few years ago.
- Wash condenser and water boxes - repair if needed.
- Clean and paint around EH units.

Week of Dec 4-7

- Ground floor:
 - Haul off junk
 - Remove electrical cage and relocate material to warehouse 2
 - Relocate equipment at southeast corner to warehouse 2

Week of Dec 11-14

- Wash ash off concrete under boiler & SSC's

Replace drains system and wash down tripper deck

Week of Dec 18-21 Christmas Vacations

General Clean-up: Turbine bldg and boiler

Week of Dec 25-28 Christmas & New Year Vacations

General Clean-up: Turbine bldg and boiler

Week of Jan 1-4

Remove ammonia tanks (West Side of plant)

Sandblast/paint Yellow protective posts throughout plant

Week of Jan 8-11

Remove trash and dirt from roof of main building

Remove trash from roof of water treater

Clean Reactor out

Week of Jan 15-18

Drain clarifier/fix leaks and clean out weeds that have grown

Remove hoses that hang over side of baghouse, affix permanent vacuum piping

Paint chemical silos above Reactor building

Week of Jan 22-25

Touch up paint as determined

Mow Plant site and access road shoulders

Wash and sweep plant grounds from boiler to Cooling towers

Week of Jan 29-Feb 1

Reinstall deflation fan lagging unit #2 baghouse

Touch up paint as determined (Yellow chemical storage tanks)

Week of Feb 5-8

General Clean-up: Turbine bldg, boiler, water treatment plant, Circ. Pit

Touch up paint as determined

Week of Feb 12-15

General Clean-up: Turbine bldg and boiler

22

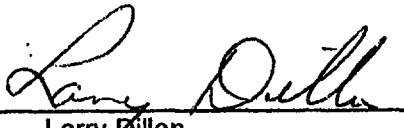
AFFIDAVIT

THE STATE OF TEXAS §

COUNTY OF TARRANT §

BEFORE ME, the undersigned notary public, this day personally appeared, and proved to me to be the person whose name is subscribed below, and, who being by me first duly sworn, on oath deposes and says:

"My name is Larry Dillon. I certify that the foregoing testimony and exhibits, offered by me on behalf of Texas-New Mexico Power Company, First Choice Power, Inc, and Texas Generating Company, L.P. are true and correct and based upon my personal knowledge and experience."


Larry Dillon

SUBSCRIBED AND SWORN TO BEFORE ME, notary public, on this 19th day of January, 2004.


Notary Public

My Commission expires: 9-3-06

23